Department of the Treasury

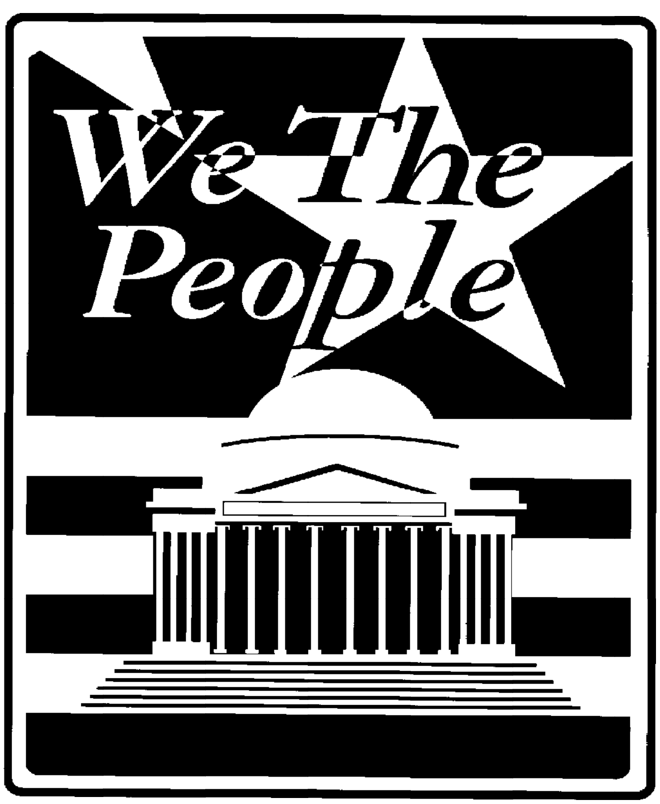
Internal Revenue Service

Publication 583
Cat. No. 15150B

Taxpayers Starting a Business

For use in preparing

1994 Returns



Contents

Important Reminders

Schedule C–EZ. You may use Schedule C–EZ, *Net Profit From Business,* for 1994 if you operated a business or practiced a profession as a sole proprietor and you meet all of the following requirements:

1) Had gross receipts of $25,000 or less.
2) Had expenses of $2,000 or less.
3) Use the cash method of accounting.
4) Did not have an inventory at any time during the year.
5) Did not have a net loss from your business.
6) Had only one business as a sole proprietor.
7) Had no employees for the year.
8) Are not required to file Form 4562, *Depreciation and Amortization,* for this business.
9) Did not deduct expenses for business use of your home.
10) Do not have prior year unallowed passive activity losses from this business.

Business use of your home. If you use part of your home for your trade or business and can deduct the expenses on Schedule C (Form 1040), *Profit or Loss From Business,* you must figure your deduction on Form 8829, *Expenses for Business Use of Your Home,* and attach it to Schedule C. For more information, see Publication 587.

Introduction

This publication discusses several topics of interest to an individual starting a small business. It looks at some decisions involved in setting up a recordkeeping system, and typical books and records for a small business. Sample records and filled-in forms are illustrated at the end of the publication.

Ordering publications and forms. To order free publications and forms, call our toll-free telephone number 1-800-TAX-FORM (1-800-829-3676). You can also write to the IRS Forms Distribution Center nearest you. Check your tax package for the address.

Telephone help. You can call the IRS with your tax question Monday through Friday during regular business hours. Check your telephone book for the local number or you can call toll-free **1-800-829-1040.**

Telephone help for hearing-impaired persons. If you have access to TDD equipment, you can call **1-800-829-4059** with your tax question or to order forms and publications. See your tax package for the hours of operation.

Useful Items

You may want to see:

Publication

- ❏ **334** Tax Guide for Small Business
- ❏ **505** Tax Withholding and Estimated Tax
- ❏ **509** Tax Calendars for 1995
- ❏ **533** Self-Employment Tax
- ❏ **538** Accounting Periods and Methods
- ❏ **587** Business Use of Your Home
- ❏ **917** Business Use of a Car
- ❏ **937** Employment Taxes
- ❏ **946** How To Begin Depreciating Your Property
- ❏ **1635** Understanding Your EIN

Form (and Instructions)

This publication discusses many different forms you may have to file with the IRS. They are not listed separately here. Please see the individual discussions.

Information from other federal agencies. Other federal agencies also publish publications and pamphlets to assist small businesses. For a list of federal publications that are for sale write to:

Superintendent of Documents
U.S. Government Printing Office
P.O. Box 371954
Pittsburgh, PA 15250-7954

If you want information from the Small Business Administration (SBA) on setting up a small business, call 1-800-827-5722.

Types of Businesses

When beginning a business, you must decide which type of business entity to use. Legal and tax considerations enter into this decision. Only tax considerations are discussed in this publication.

Normally, you conduct a business in the form of a sole proprietorship, partnership, or corporation. If your business is a sole proprietorship or partnership, the business itself does not pay income tax. The sole proprietor or the partners include the profit or loss on their personal tax returns. The profit of a corporation, except for an S corporation, is taxed both to the corporation and to the shareholders when the profit is distributed as dividends. However, except for S corporation shareholders, a shareholder generally cannot deduct any loss of the corporation.

Sole proprietorships. A sole proprietorship is the simplest form of business organization. The business has no existence apart from you, the owner. Its liabilities are your personal liabilities and you undertake the risks of the business for all assets owned, whether used in the business or personally owned.

You must report the profit or loss from each of your sole proprietorships on a separate ***Schedule C (Form 1040),*** *Profit or Loss From Business.* Enter the combined profit or loss on Form 1040, *U.S. Individual Income Tax Return.* If you operate only one business as a sole proprietorship and have a net profit, you may be able to use the simpler Schedule C-EZ.

As a sole proprietor, you may be liable for self-employment tax and estimated tax payments.

For more information on sole proprietorships, see Chapter 28 in Publication 334.

Partnerships. A partnership is not a taxable entity. However, a partnership must figure its profit or loss and file an information return on Form 1065, *U.S. Partnership Return of Income.*

A partnership is the relationship existing between two or more persons who join to carry on a trade or business. Each person contributes money, property, labor, or skill, and expects to share in the profits and losses of the business.

For more information, see Publication 541, *Tax Information on Partnerships.*

Corporations. In forming a corporation, prospective shareholders transfer money, property, or both, for the corporation's capital stock. Most corporations file Form 1120, *U.S. Corporation Income Tax Return* or Form 1120-A, *U.S. Corporation Short-Form Income Tax Return.* A corporation generally takes the same deductions as a sole proprietorship to figure its taxable income. A corporation can also take special deductions.

For more information, see Publication 542, *Tax Information on Corporations.*

S corporations. An eligible domestic corporation can avoid double taxation (once to the shareholders and again to the corporation) by electing to be treated as an S corporation. An S corporation may also be generally exempt from federal income tax. Its shareholders include in income their share of the corporation's separately stated items of income, deduction, loss, and credit, and their share of nonseparately stated income or loss.

To qualify for S corporation status, a corporation must have no more than 35 shareholders, in addition to other requirements. An S corporation files its return on Form 1120S, *U.S. Income Tax Return for an S Corporation.*

For more information, see Publication 589, *Tax Information on S Corporations.*

Identification Numbers

You must have a taxpayer identification number so that the Internal Revenue Service can process your returns. There are two kinds of taxpayer identification numbers—a social security number and an employer identification number.

Employer Identification Number (EIN)

If you are a sole proprietor, you do not need an employer identification number unless you have employees. However, you do need an EIN if you:

1) Have a Keogh plan.
2) File any of these tax returns:
   a) Employment.
   b) Excise.
   c) Fiduciary.
   d) Alcohol, tobacco, and firearms.

Otherwise, use your social security number.

You are a sole proprietor if you are self-employed (work for yourself) and are the only owner of your unincorporated business.

How To Apply for an EIN

To apply for an EIN, file Form SS–4, *Application for Employer Identification Number,* with the IRS Center for your area listed in the instructions to Form SS–4. You can get Form SS–4 at IRS or Social Security Administration (SSA) offices.

When to apply. You should file Form SS–4 early enough to receive the number by the time you must file a return or statement or make a tax deposit. It takes about four weeks to process Form SS–4.

If you do not receive your EIN by the time a return is due, file your return anyway. Write ''Applied for'' and the date you applied for the number in the space for the EIN.

If you have not received your EIN and must make a tax deposit, discussed later under *Business Taxes,* mail your payment to the IRS Center where you file your return. Make your check or money order payable to the Internal Revenue Service. On the check or money order, write your name (exactly as shown on Form SS–4), address, kind of tax, period covered, and date you applied for an EIN.

How To Use an Identification Number

You must include your taxpayer identification number (SSN or EIN) on all returns or other documents you send to the IRS. You must also furnish your number to other persons who use your identification number on any returns or documents they send to the IRS. This includes returns or documents they file to report:

1) Interest, dividends, royalties, etc., paid to you.
2) Amounts paid to you (in your business) that total $600 or more for the year.
3) Any amount paid to you as a dependent care provider.
4) Alimony paid to you.

If you do not furnish your identification number as required, you will be subject to penalties.

More than one EIN. If you have more than one EIN and are not sure which to use, contact the IRS Center where you file your return. Tell them the numbers you have, the name and address you used on each application, and the address of your principal place of business. They will tell you which number to use.

When To Apply for a New EIN

You may need to apply for a new EIN if the organization or the ownership of your business changes.

Change in organization. You need a new EIN when any of the following occurs:

1) A sole proprietorship incorporates.
2) A sole proprietorship takes in partners and operates as a partnership.
3) A partnership incorporates.
4) A partnership is taken over by one of the partners and operated as a sole proprietorship.
5) A corporation changes to a partnership or sole proprietorship.

A corporation converting to an S corporation does not need a new EIN.

Change in ownership. You need a new EIN when any of the following occurs:

1) You purchase or inherit an existing business that you will operate as a sole proprietorship. (You cannot use the EIN of the former owner, even if he or she is your spouse.)
2) You represent an estate that operates a business after the owner's death.
3) You terminate an old partnership and begin a new one.

Employee and Other Payee Numbers

In the operation of a business, you will normally make certain payments you must report on information returns, discussed later. You must give the recipient of these payments (the payee) a statement showing the total amount paid during the year. The forms used to report these payments must include the payee's identification number, as well as your identification number.

Employee. If you are an employer, you must get a social security number (SSN) from each of your employees. When you hire an employee, you should give him or her a Form W–4, *Employee's Withholding Allowance Certificate.* The employee must complete the form and return it to you. It will give you his or her SSN and the information needed to figure the income tax to withhold from the employee's salary. You will use the SSN of each employee when you report his or her wages and the withheld social security, Medicare, and income taxes. Using the SSN will ensure that each employee's account is properly credited.

If your employee does not have an SSN, he or she should file Form SS–5, *Application for Social Security Card,* with the Social Security Administration. Forms are available at SSA offices.

Other payee. If you make payments to a nonemployee that you report on an information return, get an SSN from each individual (including sole proprietors). If you make payments to an organization, such as a corporation or partnership, you must get the EIN of the organization.

To get the payee's SSN or EIN, use Form W–9, *Request for Taxpayer Identification Number and Certification.* A sole proprietor must give his or her individual name on Form W–9, as well as the SSN or EIN. This form is available from IRS offices.

A payee who does not provide you with an identification number may be subject to backup withholding of 31%. For information on backup withholding, see Form W–9 and the 1995 *Instructions for Forms 1099, 1098, 5498, and W–2G.*

Business Taxes

The type of business you operate determines what taxes you must pay and how you pay them. There are four general kinds of business taxes:

1) Income tax.
2) Self-employment tax.
3) Employment taxes.
4) Excise taxes.

Publication 509 contains a general tax calendar, an employer's tax calendar, and an excise tax calendar. Each calendar explains when to file returns and make tax payments.

Income Tax

Every business must file an annual income tax return. Which form you use depends on how your business is organized.

Organization:	File:
Sole proprietorship (except farming)	Schedule C (Form 1040)
Farming	Schedule F (Form 1040)
Partnership	Form 1065
Corporation	Form 1120 or 1120–A
S corporation	Form 1120S

If you are a sole proprietor or farmer and have more than one business, file a separate Schedule C or Schedule F for each business.

How to pay. Federal income and self-employment taxes are pay-as-you-go taxes.

Individuals. Income from your business is not subject to withholding. You generally pay the tax during the year as you earn your income. Sole proprietors, partners, or shareholders of an S corporation pay as they go by making regular payments of estimated tax during the year. If your estimated income tax and self-employment tax will be $500 or more for 1995, you generally have to make estimated tax payments. If you are not required to make estimated tax payments, you may pay any tax due when you file your return. For information on estimated tax, see Publication 505.

Corporations. A corporation must deposit the taxes it owes, including estimated tax payments and any balance due shown on its tax return. For information on how to make tax deposits, see *Depositing Taxes,* later.

Self-Employment Tax

Self-employment tax is the social security and Medicare tax for individuals who work for themselves, including sole proprietors, self-employed farmers and fishermen, and members of a partnership. You figure self-employment tax on Schedule SE and attach it to Form 1040.

For more information, see Publication 533.

Employment Taxes

If you have employees, you will pay employment taxes. These taxes include:

1) Federal income tax withholding.
2) Social security and Medicare taxes.
3) Federal unemployment (FUTA) tax.

For more information on employment taxes, including a discussion about whether an individual is an employee, see Publication 937.

Federal Income, Social Security, and Medicare Taxes

You withhold federal income tax from your employee's wages. For social security and Medicare taxes, you withhold part from your employee's wages and you pay a matching amount yourself.

Tax returns. You report and pay social security and Medicare taxes and withheld income tax together. Farm employers report these taxes on Form 943, *Employer's Annual Tax Return for Agricultural Employees.* Other employers use Form 941, *Employer's Quarterly Federal Tax Return.*

Federal Unemployment (FUTA) Tax

You report and pay FUTA tax separately from social security and Medicare taxes and withheld income tax. You pay FUTA tax only from your own funds. Employees do not pay this tax or have it withheld from their pay.

Tax return. You report federal unemployment tax on Form 940, *Employer's Annual Federal Unemployment (FUTA) Tax Return.*

Simplified form. Form 940-EZ, *Employer's Annual Federal Unemployment (FUTA) Tax Return,* is a simplified version of Form 940. You can use Form 940-EZ if:

1) You pay employment taxes to only one state,
2) You pay all state employment tax by the due date for filing Form 940-EZ,
3) The FUTA wages you pay are also taxable for state unemployment tax, and
4) You pay wages in a state that is not a credit reduction state (see Form 940-EZ instructions).

How To Pay

You generally must deposit employment taxes before you file an employment tax return. See *Depositing Taxes,* later.

For more information on reporting and deposit requirements for employment taxes, see Publication 15, *Circular E, Employer's Tax Guide,* and Publication 937. Publication 15 also contains withholding tax tables to figure the amount of social security, Medicare, and federal income tax to withhold.

Farmers. For more information on reporting and deposit requirements for employment taxes for farmers, see Publication 51, *Circular A, Agricultural Employer's Tax Guide.*

Excise Taxes

If you manufacture or sell certain products, you may have to pay excise taxes. There are also excise taxes on certain kinds of businesses, certain transactions, and the use of various kinds of equipment, facilities, and products.

Form 720. The federal excise taxes reported on Form 720, *Quarterly Federal Excise Tax Return,* consist of several broad categories:

1) Environmental taxes imposed on domestic crude oil, imported petroleum products, and certain chemicals sold by producers, manufacturers, or importers.
2) Facilities and services taxes, including taxes on amounts paid for telephone communications and air transportation.
3) Fuel taxes, including taxes on gasoline, gasohol, diesel fuel, and special motor fuels.
4) Manufacturer's taxes on the sale or use of a variety of different products.
5) Excise tax on the first retail sale of heavy trucks and trailers and luxury passenger cars.
6) Other excise taxes, including taxes on policies issued by foreign insurers and obligations not in registered form.

File Form 720 generally within one month after the end of a calendar quarter.

You may have to deposit the excise taxes reported on Form 720 before the return is due. For information on making deposits, see *Depositing Taxes,* later. For more information on the excise taxes you report on Form 720 and the deposit requirements, see Publication 510, *Excise Taxes for 1995.*

Form 2290. There is a federal excise tax on certain trucks, truck tractors, and buses used on public highways. The tax applies to vehicles having a gross vehicle weight of 55,000 pounds or more. Report the tax on Form 2290, *Heavy Vehicle Use Tax Return.* For more information, see Publication 349, *Federal Highway Use Tax on Heavy Vehicles.*

ATF forms. If you produce, sell, or import guns, tobacco, or alcohol products, or if you manufacture equipment for their production, you may be liable for one or more excise taxes. Report these taxes on forms filed with the Bureau of Alcohol, Tobacco, and Firearms. For more information on these forms, see Publication 510.

Form 730. If you are in the business of accepting bets or running a betting pool or lottery, you may be liable for federal excise taxes on wagering. Use Form 730, *Tax on Wagering,* to figure the tax on the bets you receive. For more information, see the Form 730 instructions and Publication 510.

Form 11–C. Use Form 11–C, *Occupational Tax and Registration Return for Wagering,* to register any wagering activity and to pay the occupational tax on wagering. For more information, see the Form 11–C instructions and Publication 510.

Depositing Taxes

You generally have to deposit the tax you owe before you file your return. A return can cover more than one deposit period.

Mail or deliver deposits with completed ***deposit coupons*** to an authorized financial institution or a Federal Reserve bank for your area, unless you are required to make the deposits electronically as discussed later. To help ensure proper crediting of your account, include the following on your check or money order:

1) Your EIN.
2) Type of tax.
3) Tax period for the payment.

To be on time, mailed deposits must arrive at the depository by the due date. You may be charged a penalty for not making deposits when due, unless you have reasonable cause.

Deposit the taxes from the forms listed below:

Type of Tax	Reported On
Corporate income tax	Form 1120
Social security and Medicare taxes and withheld income tax (non-agricultural)	Form 941
Social security and Medicare taxes and withheld income tax (agricultural)	Form 943
Federal unemployment (FUTA) tax	Form 940
Excise tax	Form 720

Deposit coupons. Form 8109, *Federal Tax Deposit Coupon Book,* contains coupons for depositing taxes. On each coupon, you must show the deposit amount, the type of tax, the period for which you are making a deposit, and your telephone number. Use a separate coupon for each tax and period. You must include a coupon with each deposit you make.

When you apply for an employer identification number (EIN), as discussed earlier, the IRS will send you the coupon book. If you have a deposit due and there is not enough time to obtain a coupon book, blank coupons (Form 8109–B) are available at most IRS offices. You cannot use photocopies of the coupons to make your deposits.

If you have not received your EIN and must make a deposit, mail your payment with an explanation to the IRS Center where you file your return. Make your check or money order payable to the Internal Revenue Service. On the check, write your name (exactly as shown on Form SS–4), address, kind of tax, period covered, and date you applied for an EIN.

Electronic deposit of taxes. Generally, taxpayers whose total deposits of withheld income, social security, and Medicare taxes during calendar year 1993 exceeded $78 million are required to deposit these taxes through an electronic funds transfer (EFT) system beginning in 1995.

Employers not required to make deposits by EFT may enroll in the system, which will allow tax deposits without coupons, paper checks, or visits to an authorized depositary. For more information, call 1-800-829-5469, or write to:

Internal Revenue Service
Cash Management Site Office
Atlanta Service Center
P.O. Box 47669, Stop 295
Doraville, GA 30362

More information. For more information on when deposits and business tax returns are due, see Publications 15, 51, 509, and 937.

Information Returns

You may make or receive payments in your business that you must report to the IRS.

You must report on information returns various kinds of payments made to, or certain payments received from, persons who are not your employees. The IRS uses information returns to match the payments with each person's income tax return to see if the payments were included in income. You must give a copy of each statement you are required to file to the recipient or payer.

Form 1099–MISC. Use Form 1099–MISC, *Miscellaneous Income,* to report certain payments you make in your trade or business. These include payments of $10 or more for royalties, and payments of $600 or more for rents, prizes and awards not for services rendered, and payments to persons who were not your employees (such as independent contractors).

Form 8300. You must file Form 8300, *Report of Cash Payments Over $10,000 Received in a Trade or Business,* if you receive more than $10,000 in cash or foreign currency in one or more related business transactions. For more information, see Publication 1544, *Reporting Cash Payments of Over $10,000.*

Other returns. In addition to Forms 1099–MISC and 8300, you may use other returns to report certain kinds of payments or transactions. For information on these returns, and on the general requirements for filing information returns, see the *Instructions for Forms 1099, 1098, 5498, and W-2G.*

Penalties

To be sure that all taxpayers pay their fair share of taxes, the law provides penalties if you do not file returns or pay taxes as required. Criminal penalties may be imposed for willful failure to file, tax evasion, or making a false statement.

Failure to withhold, deposit, or pay taxes. If you do not withhold income, social security, or Medicare taxes from employees, or withhold taxes but do not deposit them or pay them to the IRS, you may be subject to a penalty of the unpaid tax, plus interest. You may also be subject to penalties if you deposit the taxes late. For more information, see Publication 937.

Failure to file information returns. A penalty applies if you do not file information returns by the due date, if you do not include all required information, or if you report incorrect information.

The penalty for filing a late information return is based on the length of time the return is late.

1) If the return is filed within 30 days after the due date, the penalty is $15 for each return, up to a maximum of $75,000 a year.
2) If the return is filed after the 30-day period but by August 1, the penalty is $30 for each return, up to a maximum of $150,000 a year.
3) If the return is filed after August 1 or never filed, the penalty is $50 for each return, up to a maximum of $250,000 a year.

Small businesses pay the same penalty for a return, but the maximums are lowered to $25,000, $50,000, and $100,000 a year. (A small business is one with average annual gross receipts of $5 million or less for the last 3 years ending before the calendar year the return is due, or since the business began if shorter.)

Late payee statements. If you do not furnish a required statement to a payee by the required date, there is a penalty of $50 for each statement you do not furnish, up to a maximum of $100,000 a year. The penalty also applies if you do not include all required information, or if you report incorrect information.

Other information reporting penalties. There is a penalty of $50 each time you do not comply with certain specified information reporting requirements by the required date, up to a maximum of $100,000 a year. Most of these requirements concern furnishing and including taxpayer identification numbers on returns, statements, and other documents.

Waiver of penalty. These penalties will not apply if you can show that the failures were due to reasonable cause and not willful neglect.

In addition, there is no penalty for failure to file a *de minimis* (small) number of information returns if you correct the errors by August 1 of the year the returns are due. (A de minimis number of returns is the greater of 10 or ½ of 1% of the total number of returns you are required to file for the year.)

Checksheet for Employers

You may want to keep the following employment-related forms and publications on hand:

Forms:

- ❑ SS–5, *Application for a Social Security Card*
- ❑ W–4, *Employee's Withholding Allowance Certificate*
- ❑ 940, *Employer's Annual Federal Unemployment (FUTA) Return*
- ❑ 940-EZ, *Employer's Annual Federal Unemployment (FUTA) Return*
- ❑ 941, *Employer's Quarterly Federal Tax Return*
- ❑ 8109, *Federal Tax Deposit Coupon Book*

Publications:

- ❑ 15, *Circular E, Employer's Tax Guide*
- ❑ 937, *Employment Taxes*

Recordkeeping

Everyone in business must keep records. Good records will help you prepare accurate tax returns so that you pay only the amount of tax you owe. Good records are also needed for good management.

Advantages of Good Records

Good records can save you time and money. You need good records to show the progress of your business operations, to prepare financial statements, and to support items of income and expense reported on your tax return.

Identify source of receipts. You will receive money or property from many sources. Your records can identify the source of your receipts. You need this information to separate business from nonbusiness receipts and taxable from nontaxable income.

Keep track of deductible expenses. You may forget expenses when you prepare your tax return unless you record them when they occur.

Figure depreciation allowance. You should record the assets you can depreciate in a permanent record. You need a record of the cost and other information on your assets to figure your depreciation deductions. If you sell the assets or make capital improvements to them, only a permanent record shows how much of their cost you have recovered.

Record details of assets. Good, complete records show the date you acquired an asset, the percentage of its business use, and any changes in the basis of each asset. You need this information to figure (and to know how to report) gain or loss if you sell, trade, or otherwise dispose of it, or it is destroyed.

Determine earnings for self-employment tax purposes. The self-employment tax is the means for providing social security coverage for people who work for themselves. The social security benefits you receive when you retire, if you are disabled, or the benefits your family receives when you die, depend on how much you earn. Self-employment tax also provides you with medical insurance (Medicare) benefits. Your records should show how much self-employment tax you pay on your earnings.

Support items reported on tax returns. If the IRS examines any of your tax returns, you may be asked to explain the items reported. A complete set of records will speed up the examination. You support adequate and complete records with sales slips, invoices, receipts, deposit slips, canceled checks, certain financial account statements, and other documents.

Financial account statements as proof of payment. If you cannot provide a canceled check to prove payment of an expense item, you may be able to prove payment with certain financial account statements. This includes account statements prepared by a third party who is under contract to prepare statements for the financial institution. Acceptable account statements include:

1) An account statement showing a check clearing is accepted as proof (depending on your method of accounting) if it shows the:
   a) Check number,
   b) Amount,
   c) Payee name, and
   d) Date the check amount was posted to the account by the financial institution.
2) An account statement prepared by a financial institution showing an electronic funds transfer is accepted as proof if it shows the:
   a) Amount transferred,
   b) Payee name, and
   c) Date the transfer was posted to the account by the financial institution.
3) An account statement prepared by a financial institution showing a credit card charge (an increase to the cardholder's loan balance) is accepted as proof if it shows the:
   a) Amount charged,
   b) Payee name, and
   c) Date charged (transaction date).

These account statements must show a high degree of legibility and readability. For this purpose, legibility is the quality of a letter or number that allows it to be identified positively excluding all other letters and numbers. Readability is the quality of a group of letters or numbers that allows it to be recognized as words or complete numbers. However, this does not mean the information must be typed or printed. For example, the IRS will accept an account statement that reproduces the required information in the account holder's own handwriting from checks or charge slips.

However, proof of payment of an amount alone does not establish that you are entitled to a tax deduction. You should also keep other documents, as discussed in *Support items reported on tax returns,* earlier.

Records Required

The law does not require any special kind of records. You may choose any system suited to your business to clearly show your income.

Your permanent books, including inventory records, must show your gross income, as well as your deductions and credits. In addition, you must keep any other records and data necessary to support the entries in your books and on your tax and information returns. File paid bills, canceled checks, etc., that support entries in your books in an orderly fashion and keep them in a safe place. For most small businesses, the business checkbook is the main source for entries in the business records.

The business you are in affects the type of records you need to keep for federal tax purposes. You should set up your books using an accounting method that clearly shows your income for your tax year. If you are in more than one business, you should keep a complete and separate set of books for each business.

The sample records in this publication show the kinds of records a small business operating as a sole proprietorship can use.

Car expense records. If you use your car for business, see Publication 917 for information on the records to keep for your deduction.

Tax Year

You must figure your taxable income and file an income tax return based on an annual accounting period called a tax year. A tax year is usually 12 consecutive months. There are two kinds of tax years:

Calendar

Fiscal

If you operate a business as a sole proprietor, the tax year for your business must be the same as your individual tax year.

Calendar year. A calendar year is 12 consecutive months beginning January 1 and ending December 31. If you are a calendar year taxpayer and a sole proprietor, your business must also be on the calendar year basis.

Fiscal year. A fiscal year is 12 consecutive months ending on the last day of any month other than December, or a 52–53 week year. You must keep your books on a fiscal year basis to file a fiscal year tax return.

If you are considering using a fiscal year, see Publication 538.

Short tax year. A short tax year has less than 12 months. You will have a short tax year if your business is not in existence for an entire tax year or you change your tax year. Figuring tax for a short tax year is different for each situation. See Publication 538.

S corporations. Generally, all S corporations, regardless of when they became S corporations, must use a calendar tax year. An S corporation can use any other accounting period for which the corporation establishes a business purpose to the satisfaction of the IRS or for which it has made a section 444 election. For more information, see Publication 538.

Partnerships. All partnerships, including existing partnerships, must use a tax year that conforms to their partners' tax year, unless the partnership can establish a business purpose for a different period or makes a section 444 election. For more information, see Publication 538.

First-time filer. If you have never filed an income tax return, you can choose either a calendar year or a fiscal tax year. You must choose a tax year by the time set by law, not including extensions, for filing your first return.

You must use the calendar year if you have inadequate records or you have no accounting period, or your annual accounting period does not qualify as a fiscal year.

Accounting Method

An accounting method is a set of rules used to determine when and how to report income and expenses in your books and on your income tax returns.

You can choose any of the following accounting methods if you use it regularly and it clearly shows your income.

1) Cash method.
2) Accrual method.
3) Special methods of accounting for certain items of income and expenses.
4) Combination (hybrid) method using elements of two or more of the above.

If you need inventories to show income correctly, you must generally use an accrual method of accounting for purchases and sales.

You must use the same accounting method from year to year to figure your taxable income and keep your books if that method clearly shows your income. In general, any accounting method that consistently uses accounting principles suitable for your trade or business clearly shows income. An accounting method clearly shows income only if it treats all items of gross income and expense the same from year to year.

Cash method — reporting income. Under this method, you report income when actually or constructively received.

Constructive receipt. Constructive receipt occurs when an amount is credited to your account or made available to you without restriction as to the time or manner of payment. You do not need to have possession of it.

You cannot hold checks or postpone taking possession of similar property from one tax year to another to avoid paying tax on the income. Include this income in the year the check or other property is set aside for you and subject to your demand.

Example 1. The bank credits interest to your account on December 30, 1994. You withdraw the interest on January 3, 1995. You must include the interest in income for 1994, the year it is credited to your account, not the year it is withdrawn or entered in your passbook.

Example 2. You received a check for $250 on December 31, 1994, for an item you sold. You did not cash the check until January 3, 1995. You must include the $250 in gross receipts in 1994, the year you received the check.

Example 3. On January 3, 1995, you received and deposited a check dated December 28, 1994, for payment of goods. You must include this amount in gross receipts for 1995, the year you received the check.

Cash method — deducting expenses. You usually deduct expenses in the tax year you pay them. However, you can deduct prepaid expenses only in the year to which they apply.

Example. You are a calendar year taxpayer and pay $3,000 for an insurance policy effective July 1, 1994, for a 3–year period. You can deduct $500 in 1994, $1,000 in 1995, $1,000 in 1996, and $500 in 1997.

Limits on use of cash method. Corporations (other than S corporations) and certain partnerships with average yearly gross receipts of more than $5 million, and all tax shelters, cannot use the cash method of accounting. For more information, see Publication 538.

Accrual method — reporting income. Under an accrual method, you generally report income when you earn it, even though you may receive payment in a later year. It is not the receipt of payment that is important, but the right to receive it. All events that fix your right to receive the income must have occurred, and you must be able to figure the amount with reasonable accuracy.

Example. You are a calendar year taxpayer. You sold a computer in November 1994. You billed the customer 2 days later, but you did not receive payment until February 1995. You must include the amount of the sale in income for 1994 because you earned the income in that year.

Accrual method — deducting expenses. Under this method, you deduct expenses as you incur them, whether or not you pay them in the same year. All events that set the amount of the liability must have occurred, and you must be able to figure the amount with reasonable accuracy.

Economic performance rule. Business expenses are generally not deductible until economic performance occurs. If the expense is for property or services provided to you, or for property you use, economic performance occurs as the property or services are provided, or as you use the property. If the expense is for property or services you provide to others, economic performance occurs as you provide the property or service. You can treat certain recurring expenses as incurred during a tax year even though economic performance has not occurred. For a discussion of the economic performance rule, see Publication 538.

Example. You are a calendar year taxpayer and buy office supplies in December 1994. You received the supplies and the bill for them in December, but you pay for them in January 1995. You can deduct the expense in 1994 because all events that set the amount of the liability and economic performance occurred in that year. Your office supplies qualify as a recurring expense and you can deduct the expense in 1994, even if delivery of the supplies (economic performance) does not occur until 1995.

Cash or accrual. If you use an accrual method of accounting for purchases and sales, you can use the cash method for figuring all other income and expenses. However, if you use the cash method for figuring gross income from your business, you must use the cash method for figuring business expenses. If you use an accrual method for figuring business expenses, you must use an accrual method for figuring all items that affect the gross income from your business.

You can account for business and personal items under different accounting methods. You can figure the income from your business under an accrual method even if you use the cash method to figure personal items.

More than one business. When you own more than one business, you can use a different accounting method for each separate business if the method you use for each clearly shows your income. When you use different accounting methods, you must keep a complete and separate set of books and records for each business.

Example. You run a personal service business and a manufacturing business. You can use the cash method for the personal service business. However, you must use an accrual method or a hybrid method for the manufacturing business because inventories are required to account for your income.

Changing your method of accounting. Once you have set up your accounting method, you must get the consent of the IRS before you can change to another method. A change in accounting method not only includes a change in your overall system of accounting, but also a change in the treatment of any material item. For examples of changes that require consent and information on how to get consent for the change, see Publication 538.

Bookkeeping System

You must decide whether to use a single- or a double-entry bookkeeping system. The single-entry system of bookkeeping is the simplest to maintain, but it may not be suitable for everyone. You may find the double-entry system better because it has built-in checks and balances to assure accuracy and control.

Single-entry. A single-entry system is based on the income statement (profit or loss statement). It can be a simple and practical system if you are starting a small business. For tax purposes, the system records the flow of income and expenses through the use of:

1) A daily summary of cash receipts.
2) Monthly summaries of cash receipts and disbursements.

Double-entry. A double-entry bookkeeping system uses journals and ledgers. Transactions are first entered in a journal and then posted to ledger accounts. These accounts show income, expenses, assets (property a business owns), liabilities (debts of a business), and net worth (excess of assets over liabilities). You close income and expense accounts at the end of each accounting period. You keep asset, liability, and net worth accounts open on a permanent basis.

In the double-entry system, each account has a left side for debits and a right side for credits. It is self-balancing because you record every transaction as a debit entry in one account and as a credit entry in another. An example of a journal showing a payment of rent in October is shown in this publication.

Under this system, the total debits must equal the total credits after you post the journal entries to the ledger accounts. If the amounts do not balance, you have made an error and you must find and correct it.

At the end of each accounting period, you prepare financial statements. These are generally the income statement and the balance sheet. The income statement reflects current operations for the year. The balance sheet shows the financial position of the business in terms of assets, liabilities, and net worth on a given date.

Automatic data processing system. You can use a computer accounting system if it maintains adequate permanent records and produces a legible printout.

Recordkeeping System

You do not have to keep your records in bound books. Records are adequate if they show current income on the basis of an annual accounting period.

A recordkeeping system for a small business might include the following:

Business Checkbook

Daily Summary of Cash Receipts

Monthly Summary of Cash Receipts

Check Disbursements Journal

Depreciation Worksheet

Employee Compensation Record

You must have the books and records of your business available for inspection by the IRS.

How long to keep records. You must keep your records as long as they may be needed for the administration of any provision of the Internal Revenue Code. Keep records that support an item of income or deduction on a return until the period of limitations for that return runs out. Usually, the period of limitations for an income tax return is 3 years after the return is due or filed, or 2 years from the date the tax is paid, whichever is later.

If you have employees, you must keep all employment tax records for at least 4 years after the date the tax becomes due or is paid, whichever is later.

Keep records that verify your basis in property for as long as they are needed to figure the basis of the original or replacement property. Also, new laws may provide tax benefits to taxpayers who can prove from their records they are entitled to the benefits.

Copies of tax returns. You should keep copies of your filed tax returns. They help in preparing future tax returns and making computations if you later file a claim for refund. They may also be helpful to the executor or administrator of your estate, or to the IRS, if your original return is not available.

The Business Checkbook

The business checkbook is your basic source of information for recording your business expenses. You should deposit all daily receipts in your business checking account. You should check your account for errors by reconciling it. See *Reconciling the Checking Account* under the *Sample Record System,* later.

Consider using a checkbook that allows enough space to identify the source of deposits as business income, personal funds, or loans. You should also note on the deposit slip the source of the deposit and keep copies of all slips.

You may need a petty cash fund for small expenses. See *Petty cash fund* under the *Sample Record System,* later. You must clearly support all business expenses paid by cash with documents that show their business purpose.

You should make all payments by check to document business expenses. Write checks payable to yourself only when making withdrawals from your business for personal use. Avoid writing checks payable to cash. If you must write a check for cash to pay a business expense, include the receipt for the cash payment in your records. If you cannot get a receipt for a cash payment, you should make an adequate explanation in your records at the time of payment.

Sample Record System

The bookkeeping system illustrated on the following pages uses the principles described earlier. This is a single-entry system used by Henry M. Brown, the sole proprietor of a small automobile body shop. Henry uses part-time help, has no inventory of items held for sale, and uses the cash method of accounting.

These sample records should ***not*** be viewed as a recommendation of how to keep your records. They are intended to show one way to keep business records and how to use the records to complete Schedule C (Form 1040).

The design of Schedule C may change from year to year. Be sure to enter all items on the correct line of the current form.

Amounts on Schedule C have been rounded to the nearest dollar.

1) Daily Summary of Cash Receipts

This summary records cash sales for the day, and accounts for cash over the amount in the Change and Petty Cash Fund at the beginning of the day.

Henry may take the Cash Sales entry from his cash register tape. If he has no cash register, he may simply total his cash sale slips and any other cash received that day.

He enters the total receipts ($267.80), including cash sales ($263.60) and sales tax ($4.20) for January 3, 1994, from the *Daily Summary of Cash Receipts* in the *Monthly Summary of Cash Receipts.* This gives him the total monthly receipts to figure the total monthly taxable income.

Petty cash fund. Henry can use a petty cash fund to make small payments without having to write checks for small amounts. Each time he makes a payment from this fund, he should make out a petty cash slip and attach it to his receipt as proof of payment. He should set up a fixed amount in his petty cash fund ($50 is the amount shown for this example). The total of the unspent petty cash and the amounts on the petty cash slips should equal the fixed amount of the fund. When the totals on the petty cash slips approach the fixed amount, he brings the cash in the fund back to the fixed amount by writing a check to ‘‘Petty Cash’’for the total of the outstanding slips. (See the *Check Disbursements Journal* entry for check number 91.) This restores the fund to its fixed amount of $50. He then summarizes the slips and enters them in the proper columns in the monthly check disbursements journal.

2) Monthly Summary of Cash Receipts

This shows the income activity for the month with such items as net sales, sales tax, daily receipts, and deposits in separate columns. The net sales figure for the year is the principal income item (Gross receipts or sales) on Schedule C.

The total monthly net sales ($4,865.05) is carried to the *Annual Summary for Schedule C Entries* to figure gross receipts for the year.

To figure total monthly net sales, Henry reduces the total monthly receipts by the sales tax to be turned over to the state. He cannot take a deduction for sales tax turned over to the state because he only collected the tax. He did not include the tax in his income.

As an alternative, he can include the total sales tax collected in gross receipts and take a deduction for sales taxes paid to the state on the taxes line of Schedule C. Various states and local jurisdictions have different requirements for the collection of sales taxes. He should contact the taxing authorities in his area for sales tax regulations.

3) Check Disbursements Journal

Henry should enter checks drawn on the business checking account in the *Check Disbursements Journal* each day. All checks should be prenumbered and each check number listed and accounted for in the column provided in the journal.

Frequent expenses have their own headings across the sheet. He should enter in a separate column expenses that require comparatively numerous or large payments each month, such as materials, gross payroll, and rent. Under the general account column, he can enter small expenses that normally have only one or two monthly payments, such as licenses and postage.

Henry should not pay personal or nonbusiness expenses by checks drawn on the business account. If they are drawn on the business account, he should record them in the journal, even though he cannot deduct them as business expenses.

Henry carries the monthly total of materials ($1,083.50) to the *Annual Summary for Schedule C Entries.* Similarly, he enters monthly expenses for telephone, truck, auto, etc., in the appropriate columns of this summary.

4) Employee Compensation Record

This record shows the number of hours his employee worked in a pay period and the employee's total pay for the period. It also shows withheld deductions used to figure the employee's net pay.

The employee compensation record also records the monthly gross payroll, which is carried to the *Annual Summary for Schedule C Entries.*

5) Annual Summary for Schedule C Entries

This annual summary of monthly cash receipts and expense totals provides the final amounts to enter on Henry's tax return. He figures the annual summary from the total of monthly cash receipts items, as shown on the *Monthly Summary of Cash Receipts.* He figures the monthly expenses from the *Check Disbursements Journal.* As in the journal, he keeps each major expense in a separate column.

Henry enters the cash receipts total ($47,440.95) from the annual summary on line 1, Part I of Schedule C.

He carries the total for materials ($10,001.00) from the annual summary to line 22 of Part II.

There are no inventories of materials and supplies in this example. Henry buys parts and supplies on a per-job basis and uses them only for body work services. A business that carries materials and supplies on hand, unless they are incidental and records of use are not kept, must complete the inventory lines in Part III of Schedule C.

Henry enters annual totals for interest, rent, taxes, and wages on the appropriate lines of Schedule C. The total for taxes and licenses includes the employer's share of social security and Medicare taxes, the federal unemployment (FUTA) tax, and the business license fee. He enters the total of other annual business expenses on line 27 of Schedule C.

6) Depreciation Worksheet

Another major item entered on Schedule C is the depreciation allowed on assets used in Henry's trade or business. The sample depreciation worksheet shows examples of items depreciated using the modified accelerated cost recovery system (MACRS). Depreciation is discussed in Publication 534, *Depreciation,* and Publication 946.

Henry must take depreciation in the year it is allowable. He cannot deduct in the current year the allowable depreciation he did not take in a prior year. He must amend the prior year's tax return to take the depreciation deduction.

He can deduct up to $17,500 of the cost of certain depreciable property purchased and placed in service in his trade or business during 1994. This is the ''section 179 deduction.'' For each dollar of investment in section 179 property over $200,000 in a tax year, the $17,500 maximum is reduced (but not below zero) by one dollar. The section 179 deduction is discussed in Publications 534 and 946.

The amount of depreciation Henry can claim for the tax year is shown on his depreciation worksheet. He carries the deduction for the tax year ($18,724) from line 20, Part IV of Form 4562, to line 13, Part II of Schedule C (Form 1040).

Reconciling the Checking Account

When Henry receives his bank statement, he makes sure the statement, checkbook, and books agree. The statement balance may not agree with the balance in his checkbook and books if the statement:

1) Includes bank charges that he did not enter in his books and subtract from his checkbook balance, or
2) Does not include deposits made after the statement date or checks that did not clear his account before the statement date.

By reconciling his checking account, he will:

1) Verify how much money he has in the account,
2) Make sure that his checkbook and books reflect all bank charges and the correct balance in the checking account, and
3) Correct any errors in his bank statement, checkbook, and books.

He should reconcile his checking account each month.

Before he starts to reconcile his monthly bank statement, he checks his own figures. He begins with the balance shown in his checkbook at the end of the previous month. To this balance, he adds the total cash deposited during the month and subtracts the total cash disbursements. The *Monthly Summary of Cash Receipts* shows the monthly total of his bank deposits. The total cash disbursements is in the ''Amount of Check'' column of his *Check Disbursements Journal.*

After checking his figures, the result should agree with his checkbook balance at the end of the month. If the result does not agree with his checkbook balance at the end of the month, Henry may have made an error in recording check or deposit amounts. He can find the errors by:

1) Adding the amounts on his check stubs and comparing that total with the total in the ''Amount of Check'' column of his *Check Disbursements Journal.* If the totals do not agree, he checks the individual amounts to see if an error was made in his check stub record or in the related entry in the ''Amount of Check'' column of his *Check Disbursements Journal.*
2) Adding the deposit amounts in his checkbook. He compares that total with the monthly total of ''Daily Receipts'' in the *Monthly Summary of Cash Receipts.* If the totals do not agree, he checks the individual amounts to find any errors.

If his checkbook and journal entries still disagree, he then refigures the running balance in his checkbook to make sure additions and subtractions are correct.

Steps to reconcile the checking account. When Henry's checkbook balance agrees with the balance figured from the journal entries, he may begin reconciling his checkbook record with the bank statement. Many banks print a reconciliation worksheet on the back of the statement.

To reconcile his account, Henry:

1) Compares the amounts on all canceled checks and other debit slips (such as service charges) with the amounts listed on the statement. He makes sure he issued all checks correctly and charged correct amounts against his account.
2) Compares the deposits listed on the bank statement with deposit amounts shown in his checkbook. He accounts for all differences. He lists in the first section of the reconciliation any deposits entered in his checkbook that do not appear on the bank statement. In the sample reconciliation, the bank prepares the statement near the end of the month and the deposits of $701.33 and $516.08 do not appear on the bank statement.
3) Puts all the canceled checks in numerical order.
4) Compares each canceled check, including both check number and dollar amount, with the entry on his check stub. If correct, he marks that number on the checkbook as having cleared the bank. After accounting for all checks returned by the bank, those not marked on his checkbook are his outstanding checks. He lists in the next section of the reconciliation these outstanding checks. In the sample reconciliation, checks numbered 89, 90, 93, and 94 are still outstanding.
5) Enters any errors he finds in the preceding steps in the last section of the reconciliation under ''Add'' or ''Subtract.''
6) Enters service charges and other bank debits, determined in step (1) in the last section of the reconciliation, under ''Add'' or ''Subtract.''
7) Updates his checkbook by entering items on the reconciliation but not recorded (such as service charges). At this point, the adjusted bank statement should equal his adjusted checkbook balance. If he still has differences, he should check to find errors in the previous steps.

In the illustrated sample reconciliation, Henry must decrease the checkbook balance to reflect the net adjustment of $4 ($10 minus $6). The only book adjustment needed is to the *Check Disbursements Journal* for the $10 bank service charge. No adjustment is needed on the *Monthly Summary of Cash Receipts* because the January 8 deposit of $600.40 was correctly entered in that record.

Daily summary cash receipts
Monthly summary cash receipts
Check disbursements
Check disbursements contd
Employee compensation record
Annual summary of Sch C entries and Depreciation worksheet
Form 4562 pg 1
Form 4562 pg 2
Sch C pg 1
Sch C pg 2
Check reconciliation

Daily Summary of Cash Receipts

January 3, 1994

Cash Sales		263 60
Sales Tax		4 20
Total Receipts		267 80
Cash on Hand		
Cash in Register (Including unspent petty cash)		
Coins	23 75	
Bills	143 00	
Checks	134 05	
Total Cash in Register		300 80
Petty Cash Slips		17 00
Total Cash		317 80
Less: Change and Petty Cash		
Petty Cash Slips	17 00	
Coins and Bills (unspent petty cash)	33 00	
Total Change and Petty Cash Fund		50 00
Total Cash Receipts		267 80

2) Monthly Summary of Cash Receipts

Date 1994		Net Sales	Sales Tax	Daily Receipts	Deposit
Jan	3	263 60	4 20	267 80	
	4	212 00	3 39	215 39	
	5	194 40	3 10	197 50	680 69
	6	222 40	3 54	225 94	
	7	231 15	3 68	234 83	
	8	137 50	2 13	139 63	600 40
	10	187 90	2 99	190 89	
	11	207 56	3 31	210 87	401 76
	12	128 95	2 05	131 00	
	13	231 40	3 77	235 17	
	14	201 28	3 21	204 49	
	15	88 01	1 40	89 41	660 07
	17	210 95	3 36	214 31	
	18	221 80	3 53	225 33	434 64
	19	225 15	3 59	228 74	
	20	221 93	3 52	225 45	
	21	133 53	2 13	135 66	589 85
	22	130 84	2 08	132 92	
	24	216 37	3 45	219 82	352 74
	25	220 05	3 50	223 55	
	26	197 80	3 15	200 95	
	27	272 49	4 34	276 83	701 33
	28	150 64	2 40	153 04	
	29	224 05	3 56	227 61	
	31	133 30	2 13	135 43	516 08
		4865 05	77 51	4942 56	4942 56

3) Check Disbursements Journal

1994		Paid To	Ck. No.	Amount of Check		Materials		Gross Payroll		Federal Withheld Income Tax		FICA Social Security Reserve		FICA Medicare Reserve	
Jan	3	Dale Advertising	74	85	00										
	4	City Treasurer	75	35	00										
	4	Auto Parts, Inc.	76	203	00	203	00								
	4	John E. Marks	77	214	11			260	00	(20	00)	(16	12)	(3	77)
	6	Henry Brown	78	250	00										
	6	Mike's Deli	79	36	00										
	6	Joe's Service Sta.	80	74	50	29	50								
	6	ABC Auto Paint	81	137	50	137	50								
	7	Henry Brown	82	225	00										
	14	Telephone Co.	83	27	00										
	18	National Bank	84	90	74										
	18	Auto Parts, Inc.	85	472	00	472	00								
	18	Henry Brown	86	275	00										
	18	John E. Marks	87	214	11			260	00	(20	00)	(16	12)	(3	77)
	21	Electric Co.	88	175	30										
	21	M.B. Ignition	89	66	70	66	70								
	21	Baker's Fender Co.	90	9	80	9	80								
	21	Petty Cash	91	17	00	15	00								
	21	Henry Brown	92	225	00										
	25	Baker's Fender Co.	93	150	00										
	25	Enterprise Properties	94	300	00										
	25	National Bank (Tax Deposit)	95	119	56					40	00	32	24	7	54
	25	State Treasurer	96	12	00										
	25	State Treasurer	97	65	08										
				3,479	40	1,083	50	520	00	-0-		-0-		-0-	
		Bank Service Chg.		10	00										
				3,489	40	1,083	50	520	00	-0-		-0-		-0-	

3) Check Disbursements Journal (cont'd)

State Withheld Income Tax	Employer's FICA Tax	Electric	Interest	Rent	Telephone	Truck/ Auto	Drawing	General Accounts	
								Advertising	85
								License	35
(6 00)									
							250 00		
								Shop Holiday Party	36
						45 00			
							225 00		
					27 00				
			18 09					Loan	72
							275 00		
(6 00)									
		175 30							
								Postage	2
							225 00		
				300 00					
	39 78								
12 00									
								Sales Tax	65
-0-	39 78	175 30	18 09	300 00	27 00	45 00	975 00		295
									10
-0-	39 78	175 30	18 09	300 00	27 00	45 00	975 00		305

4) Employee Compensation Record

NAME John E. Marks
ADDRESS 1 Elm St, Newark, NJ 07101
PHONE 555-6075

FULL TIME
PART TIME X

SOC. SEC. NO. 567-00-8901
DATE OF BIRTH 12-21-65
NO. OF EXEMPTIONS 1 / Single

Pay Period Ending	Hours Worked														Total Reg. Hours	Over-time	Earnings			Deductions					Net Pay
	S	M	T	W	T	F	S	S	M	T	W	T	F	S			Regular Rate	Overtime Rate	Total	Social Security	Medicare	Fed. Income Tax	State Income Tax	Other	
1-1-94		5		5	5	5			5		5	4	6		40		$6.50		$260.00	$16.12	$3.77	$20.00	$6.00		$214.11
1-15-94		4	4	4	4	4	2		4	3	4	4	3		40		6.50		260.00	16.12	3.77	20.00	6.00		214.11
															80				$520.00	$32.24	$7.54	$40.00	$12.00		$428.22
QUARTERLY TOTALS																									

5) Annual Summary of Schedule C Entries

	Cash Receipts	Materials/ Supplies	Gross Payroll	FICA Taxes	Bank Charges	Electric	Interest	Insurance
January	4,865.05	1,083.50	520.00	39.78	10.00	175.30	18.09	
February	3,478.32	874.93	235.40	17.65	7.50	153.10	18.09	210.00
March	4,914.00	724.90	507.80	38.84	11.25	145.81	18.09	
April	4,073.02							
May	4,066.32							
June	4,161.62							
July	3,812.12							
August	3,741.82							
September	4,136.52							
October	3,877.72							
November	3,645.92							
December	4,656.52							
Totals	47,790.75	10,801.60	5,434.00	405.09	92.50	1,642.37	217.08	420.00
Enter on Schedule C	Line 1	Line 22	Line 26	Line 23	Line 27	Line 25	Line 16b	Line 15

	Rent	Telephone	Truck/Auto	Advertising	Office Expenses	Taxes/ Licenses	Miscellaneous
January	300.00	27.00	45.00	35.00	30.00	10.08	28.00
February	300.00	21.60	28.50				
March	300.00	32.10	61.00				
April							
May							
June							
July							
August							
September							
October							
November							
December							
Totals	3,600.00	324.09	571.46	35.00	360.00	218.00	336.00
Enter on Schedule C	Line 20b	Line 25	Line 10	Line 8	Line 18	Line 23	Line 27

6) Depreciation Worksheet

Description of Property	Date Placed in Service	Cost or Other Basis	Business/ Investment Use %	Section 179 Deduction	Depreciation Prior Years	Basis for Depreciation	Method/ Convention	Recovery Period	Rate or Table %	Depreciation Deduction
Equipment-Transmission-Jack	1-3-94	1,366	100%	–	–	1366	200 DB/HY	7	14.29 %	195
Pickup Truck (Used)	1-3-94	3,500	100%	2,000	–	1500	200 DB/HY	5	20 %	300
Heavy Duty Tow Truck	1-3-94	18,000	100%	15,500	–	2,500	200 DB/HY	5	20 %	500
Equipment-Engine Hoist	1-3-94	1,600	100%	–	–	1,600	200 DB/HY	7	14.29 %	229
										1,224

Form **4562** | **Depreciation and Amortization** | OMB No. 1545-0172

(Including Information on Listed Property)

1994

Department of the Treasury Internal Revenue Service (T) ▶ See separate instructions. ▶ Attach this form to your return. Attachment Sequence No. 67

Name(s) shown on return: Henry M. Brown — Identifying number: 123-00-6789

Business or activity to which this form relates: Auto Repair Service

Part I **Election To Expense Certain Tangible Property (Section 179)** (Note: *If you have any "Listed Property," complete Part V before you complete Part I.*)

1	Maximum dollar limitation (If an enterprise zone business, see instructions.)	1	$17,500
2	Total cost of section 179 property placed in service during the tax year (see instructions)	2	24,466
3	Threshold cost of section 179 property before reduction in limitation	3	$200,000
4	Reduction in limitation. Subtract line 3 from line 2. If zero or less, enter -0-	4	-0-
5	Dollar limitation for tax year. Subtract line 4 from line 1. If zero or less, enter -0-. (If married filing separately, see instructions.)	5	17,500

	(a) Description of property	(b) Cost	(c) Elected cost
6			

7	Listed property. Enter amount from line 26	7	17,500
8	Total elected cost of section 179 property. Add amounts in column (c), lines 6 and 7	8	17,500
9	Tentative deduction. Enter the smaller of line 5 or line 8	9	17,500
10	Carryover of disallowed deduction from 1993 (see instructions)	10	-0-
11	Taxable income limitation. Enter the smaller of taxable income (not less than zero) or line 5 (see instructions)	11	17,500
12	Section 179 expense deduction. Add lines 9 and 10, but do not enter more than line 11	12	17,500
13	Carryover of disallowed deduction to 1995. Add lines 9 and 10, less line 12 ▶	13	-0-

Note: *Do not use Part II or Part III below for listed property (automobiles, certain other vehicles, cellular telephones, certain computers, or property used for entertainment, recreation, or amusement). Instead, use Part V for listed property.*

Part II **MACRS Depreciation For Assets Placed in Service ONLY During Your 1994 Tax Year (Do Not Include Listed Property)**

(a) Classification of property	(b) Month and year placed in service	(c) Basis for depreciation (business/investment use only—see instructions)	(d) Recovery period	(e) Convention	(f) Method	(g) Depreciation deduction
Section A—General Depreciation System (GDS) (see instructions)						
14a 3-year property						
b 5-year property						
c 7-year property		2,966	7	HY	200DB	424
d 10-year property						
e 15-year property						
f 20-year property						
g Residential rental property			27.5 yrs.	MM	S/L	
			27.5 yrs.	MM	S/L	
h Nonresidential real property			39 yrs.	MM	S/L	
				MM	S/L	
Section B—Alternative Depreciation System (ADS) (see instructions)						
15a Class life					S/L	
b 12-year			12 yrs.		S/L	
c 40-year			40 yrs.	MM	S/L	

Part III **Other Depreciation (Do Not Include Listed Property)**

16	GDS and ADS deductions for assets placed in service in tax years beginning before 1994 (see instructions)	16	
17	Property subject to section 168(f)(1) election (see instructions)	17	
18	ACRS and other depreciation (see instructions)	18	

Part IV **Summary**

19	Listed property. Enter amount from line 25	19	800
20	**Total.** Add deductions on line 12, lines 14 and 15 in column (g), and lines 16 through 19. Enter here and on the appropriate lines of your return. (Partnerships and S corporations—see instructions)	20	18,724
21	For assets shown above and placed in service during the current year, enter the portion of the basis attributable to section 263A costs (see instructions)	21	

For Paperwork Reduction Act Notice, see page 1 of the separate instructions. Cat. No. 12906N Form **4562** (1994)

Part V Listed Property—Automobiles, Certain Other Vehicles, Cellular Telephones, Certain Computers, and Property Used for Entertainment, Recreation, or Amusement

*For any vehicle for which you are using the standard mileage rate or deducting lease expense, complete **only** 22a, 22b, columns (a) through (c) of Section A, all of Section B, and Section C if applicable.*

Section A—Depreciation and Other Information (Caution: *See instructions for limitations for automobiles.*)

22a Do you have evidence to support the business/investment use claimed? ☑ Yes ☐ No **22b** If "Yes," is the evidence written? ☑ Yes ☐ No

(a) Type of property (list vehicles first)	(b) Date placed in service	(c) Business/ investment use percentage	(d) Cost or other basis	(e) Basis for depreciation (business/investment use only)	(f) Recovery period	(g) Method/ Convention	(h) Depreciation deduction	(i) Elected section 179 cost
23 Property used more than 50% in a qualified business use (see instructions):								
Pickup truck	1-3-94	100%	3,500	1,500	5	200 DB/HY	300	2,000
Tow truck	1-3-94	100 %	18,000	2,500	5	200 DB/HY	500	15,500
		%						
24 Property used 50% or less in a qualified business use (see instructions):								
		%				S/L –		
		%				S/L –		
		%				S/L –		

25 Add amounts in column (h). Enter the total here and on line 19, page 1 . . . . **25** 800

26 Add amounts in column (i). Enter the total here and on line 7, page 1 . . . . **26** 17,500

Section B—Information on Use of Vehicles—*If you deduct expenses for vehicles:*

- *Always complete this section for vehicles used by a sole proprietor, partner, or other "more than 5% owner," or related person.*
- *If you provided vehicles to your employees, first answer the questions in Section C to see if you meet an exception to completing this section for those vehicles.*

	(a) Vehicle 1		(b) Vehicle 2		(c) Vehicle 3		(d) Vehicle 4		(e) Vehicle 5		(f) Vehicle 6	
27 Total business/investment miles driven during the year (DO NOT include commuting miles)	10,000		20,000									
28 Total commuting miles driven during the year	-0-		-0-									
29 Total other personal (noncommuting) miles driven	-0-		-0-									
30 Total miles driven during the year. Add lines 27 through 29.	10,000		20,000									
	Yes	No	Yes	No	Yes	No	Yes	No	Yes	No	Yes	No
31 Was the vehicle available for personal use during off-duty hours?		✓		✓								
32 Was the vehicle used primarily by a more than 5% owner or related person?	✓		✓									
33 Is another vehicle available for personal use?	✓		✓									

Section C—Questions for Employers Who Provide Vehicles for Use by Their Employees

*Answer these questions to determine if you meet an exception to completing Section B. **Note:** Section B must always be completed for vehicles used by sole proprietors, partners, or other more than 5% owners or related persons.*

	Yes	No
34 Do you maintain a written policy statement that prohibits all personal use of vehicles, including commuting, by your employees?		
35 Do you maintain a written policy statement that prohibits personal use of vehicles, except commuting, by your employees? (See instructions for vehicles used by corporate officers, directors, or 1% or more owners.)		
36 Do you treat all use of vehicles by employees as personal use?		
37 Do you provide more than five vehicles to your employees and retain the information received from your employees concerning the use of the vehicles?		
38 Do you meet the requirements concerning qualified automobile demonstration use (see instructions)? . .		

Note: *If your answer to 34, 35, 36, 37, or 38 is "Yes," you need not complete Section B for the covered vehicles.*

Part VI Amortization

(a) Description of costs	(b) Date amortization begins	(c) Amortizable amount	(d) Code section	(e) Amortization period or percentage	(f) Amortization for this year
39 Amortization of costs that begins during your 1994 tax year:					

40 Amortization of costs that began before 1994 . . . . **40**

41 Total. Enter here and on "Other Deductions" or "Other Expenses" line of your return . . . **41**

Printed on recycled paper

SCHEDULE C (Form 1040)

Department of the Treasury Internal Revenue Service (T)

Profit or Loss From Business

(Sole Proprietorship)

▶ **Partnerships, joint ventures, etc., must file Form 1065.**

▶ **Attach to Form 1040 or Form 1041.** ▶ **See Instructions for Schedule C (Form 1040).**

OMB No. 1545-0074

1994

Attachment Sequence No. **09**

Name of proprietor: Henry M. Brown

Social security number (SSN): 123 : 00 : 6789

A Principal business or profession, including product or service (see page C-1): Auto repair service

B Enter principal business code (see page C-6) ▶ 8953

C Business name. If no separate business name, leave blank: Brown's Auto Body Shop

D Employer ID number (EIN), if any: 10 9999999

E Business address (including suite or room no.) ▶ 5 Amherst Ave.
City, town or post office, state, and ZIP code: Newark, NJ 07103

F Accounting method: (1) ☑ Cash (2) ☐ Accrual (3) ☐ Other (specify) ▶

G Method(s) used to value closing inventory: (1) ☐ Cost (2) ☐ Lower of cost or market (3) ☐ Other (attach explanation) (4) ☑ Does not apply (if checked, skip line H)

	Yes	No
H Was there any change in determining quantities, costs, or valuations between opening and closing inventory? If "Yes," attach explanation		
I Did you "materially participate" in the operation of this business during 1994? If "No," see page C-2 for limit on losses.	✓	

J If you started or acquired this business during 1994, check here ▶ ☑

Part I Income

1	Gross receipts or sales. **Caution:** *If this income was reported to you on Form W-2 and the "Statutory employee" box on that form was checked, see page C-2 and check here* ▶ ☐	1	47,441 00
2	Returns and allowances	2	
3	Subtract line 2 from line 1	3	47,441 00
4	Cost of goods sold (from line 40 on page 2)	4	
5	**Gross profit.** Subtract line 4 from line 3	5	47,441 00
6	Other income, including Federal and state gasoline or fuel tax credit or refund (see page C-2)	6	
7	**Gross income.** Add lines 5 and 6 ▶	7	47,441 00

Part II Expenses. Enter expenses for business use of your home only on line 30.

8 Advertising	8	85 00	19 Pension and profit-sharing plans	19	
9 Bad debts from sales or services (see page C-3)	9		20 Rent or lease (see page C-4):		
			a Vehicles, machinery, and equipment	20a	
10 Car and truck expenses (see page C-3)	10	571 00	b Other business property	20b	3,600 00
			21 Repairs and maintenance	21	
11 Commissions and fees	11		22 Supplies (not included in Part III)	22	10,001 00
12 Depletion	12		23 Taxes and licenses	23	626 00
13 Depreciation and section 179 expense deduction (not included in Part III) (see page C-3)	13	18,724 00	24 Travel, meals, and entertainment:		
			a Travel	24a	
			b Meals and entertainment		
14 Employee benefit programs (other than on line 19)	14		c Enter 50% of line 24b subject to limitations (see page C-4)		
15 Insurance (other than health)	15	420 00			
16 Interest:					
a Mortgage (paid to banks, etc.)	16a		d Subtract line 24c from line 24b	24d	
b Other	16b	217 00	25 Utilities	25	1,966 00
17 Legal and professional services	17		26 Wages (less employment credits)	26	5,434 00
18 Office expense	18	40 00	27 Other expenses (from line 46 on page 2)	27	437 00

28	**Total expenses** before expenses for business use of home. Add lines 8 through 27 in columns ▶	28	42,121 00
29	Tentative profit (loss). Subtract line 28 from line 7	29	5,320 00
30	Expenses for business use of your home. Attach **Form 8829**	30	-0-
31	**Net profit or (loss).** Subtract line 30 from line 29. • If a profit, enter on **Form 1040, line 12,** and ALSO on **Schedule SE, line 2** (statutory employees, see page C-5). Estates and trusts, enter on Form 1041, line 3. • If a loss, you MUST go on to line 32.	31	5,320 00

32 If you have a loss, check the box that describes your investment in this activity (see page C-5).
• If you checked 32a, enter the loss on **Form 1040, line 12,** and ALSO on **Schedule SE, line 2** (statutory employees, see page C-5). Estates and trusts, enter on Form 1041, line 3.
• If you checked 32b, you MUST attach **Form 6198.**

32a ☐ All investment is at risk.
32b ☐ Some investment is not at risk.

For Paperwork Reduction Act Notice, see Form 1040 instructions. Cat. No. 11334P **Schedule C (Form 1040) 1994**

Part III Cost of Goods Sold (see page C-5)

33	Inventory at beginning of year. If different from last year's closing inventory, attach explanation	33		
34	Purchases less cost of items withdrawn for personal use	34		
35	Cost of labor. Do not include salary paid to yourself	35		
36	Materials and supplies	36		
37	Other costs	37		
38	Add lines 33 through 37	38		
39	Inventory at end of year	39		
40	**Cost of goods sold.** Subtract line 39 from line 38. Enter the result here and on page 1, line 4	40		

Part IV Information on Your Vehicle.
Complete this part **ONLY** if you are claiming car or truck expenses on line 10 and are not required to file Form 4562 for this business. See the instructions for line 13 on page C-3 to find out if you must file.

41 When did you place your vehicle in service for business purposes? (month, day, year) ▶ ...../...../.....

42 Of the total number of miles you drove your vehicle during 1994, enter the number of miles you used your vehicle for:

a Business .... b Commuting .... c Other ....

43 Do you (or your spouse) have another vehicle available for personal use? ☐ Yes ☐ No

44 Was your vehicle available for use during off-duty hours? ☐ Yes ☐ No

45a Do you have evidence to support your deduction? ☐ Yes ☐ No

b If "Yes," is the evidence written? ☐ Yes ☐ No

Part V Other Expenses.
List below business expenses not included on lines 8–26 or line 30.

Bank service charge	93	00
Miscellaneous	344	00
46 Total other expenses. Enter here and on page 1, line 27 — 46	437	00

Check Reconciliation as of
January 31, 1994

Balance shown on bank statement		1458.12
Add deposits not credited:		
1/28	701.33	
1/31	516.08	
		1217.41
		2675.53
Subtract outstanding checks:		
No. 89	66.70	
90	9.80	
93	150.00	
94	300.00	
		526.50
Adjusted balance per bank statement		2149.03
Balance shown in checkbook		2153.03
Add: Deposit of $600.40 for 1/8		
entered as $594.40 (difference)		6.00
		2159.03
Subtract		
Bank service charge		10.00
Adjusted checkbook balance		2149.03